

# MOSCOW Financial weekly

For the Week Ending September 21, 2001

Treasury Attache's office, US Embassy Moscow

## Highlights This Week

- An apparent deal on revenues in the 2002 budget
- CBR may allow foreign bank branches
- **No Weekly Focus this week; back next week**

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	29.4023	-0.15	4.40
Monetary Base*	R646.5 bln	2.73	33.93
CPI	NA	0	13.2
International Reserves*	\$37.1 bln	-0.80	31.10
RTS Index (end of week)	183.67	-4.35	29.08
Refinancing rate	25	0	0

\*For week prior

## Economic Developments

Tough negotiations last week between the Duma and GOR apparently resulted in an agreement to increase estimated 2002 budget revenues by R127 billion (\$4 billion). R24 billion of this will go to the pension fund, with the remaining R104 billion divided equally between debt service and spending. Because the budget already fully funds all debt obligations in 2002, the funds allocated to debt repayment will either be saved until 2003 or used to buy back some of Russia's external debt stock. Additional spending items will be negotiated before the second reading but will likely include some social spending and some additional funding for anti-terrorism. The higher revenue estimate appears realistic, though obviously susceptible to a drop in oil prices. This should pave the way for passage of the budget in the first reading on the September 28<sup>th</sup>.

Industrial growth in August was 5.1% y-o-y (6.2% m-o-m). This is an improvement over 4.5% y-o-y growth in July and 3.7% y-o-y in June. Growth was lead by industries such as construction materials, highlighting continued solid domestic demand.

Finance Minister Kudrin said that Russia plans to issue \$2 billion of Eurobonds in 2003. This comes on top of earlier statements of similar amount in 2002. It is unclear why he made the statement now though, overall, MinFin does appear to be taking an increasing proactive approach to managing its external debt.

Demand in the latest CBR's \$50 million currency auction for S-Account holders on September 20 was \$138.69 million. The cut-off price was set by the CBR at R31.40/\$.

## **Banking sector**

In order to encourage foreign investment in the banking sector, CBR Deputy Chairman Luntovsky said that CBR may soon issue regulations on opening foreign bank branches in Russia. Opening a branch presumably will be easier than registering a new bank. Luntovsky reiterated that there is no limitation on foreign participation in the Russian banking system (i.e. the 12% limit on aggregate foreign capital is not in effect) and the CBR currently does not consider imposing any restrictions.

Meanwhile CBR and the oligarchs have been publicly sparing in the lead up to the GOR discussion on the banking reform strategy scheduled for this Thursday. Luntovsky confirmed that the CBR is against increasing minimal capital requirements for commercial banks, but if this issue is raised, it would defend 5 million Euro as the highest threshold. Alexander Mamut (MDM bank) and Peter Aven (Alfa bank), representing the Union of Industrialists and Entrepreneurs, still insist that higher minimal capital is necessary and that 5 million Euro not sufficient. (Aven has lately supported 20 million Euro.) However, he pointed out that banking reform should be evolutionary, rather than revolutionary, while containing specific goals and deadlines. This leaves the door open for a compromise.

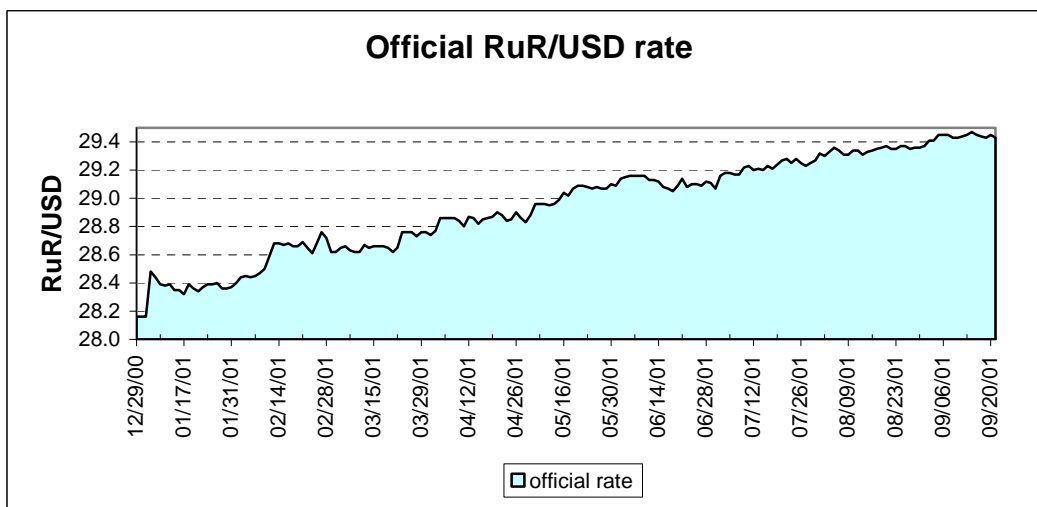
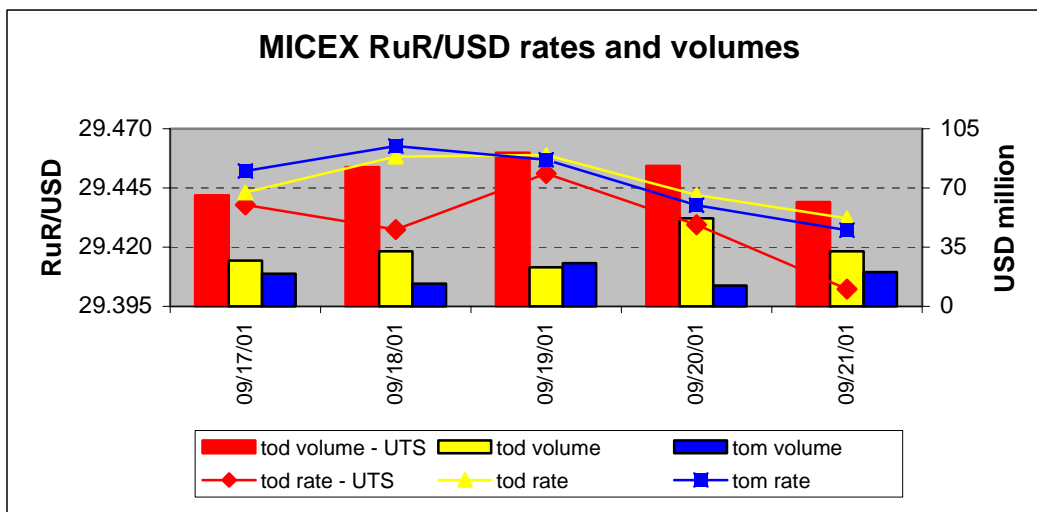
CBR Chairman Gerschenko confirmed that he would not seek another term when his term expires next September. This is presumably good news for those who see him as a major impediment to bank reform.

## **Financial markets**

### **Forex Market**

The currency market has not yet fully recovered after the terror attack on the U.S., which caused malfunctions in clearing through American banks. Not all credit lines have been restored and some banks still work with a limited circle of counterparts. Last week the dollar rate was 2-3 kopeks higher on average in the interbank market than at MICEX, and at exchange points the average dollar rate was 2-3 kopeks lower. MICEX trade volumes were relatively low, peaking on Wednesday due to increased sales of export earnings. By the end of the week, when banks started making VAT payments, the dollar weakened against the ruble.

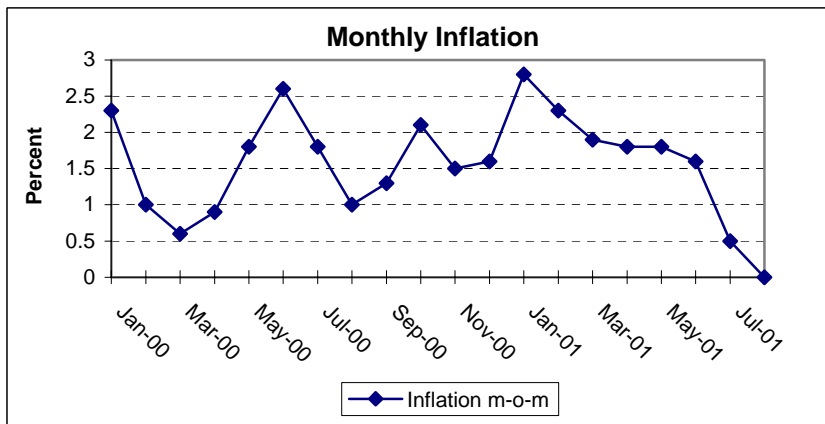
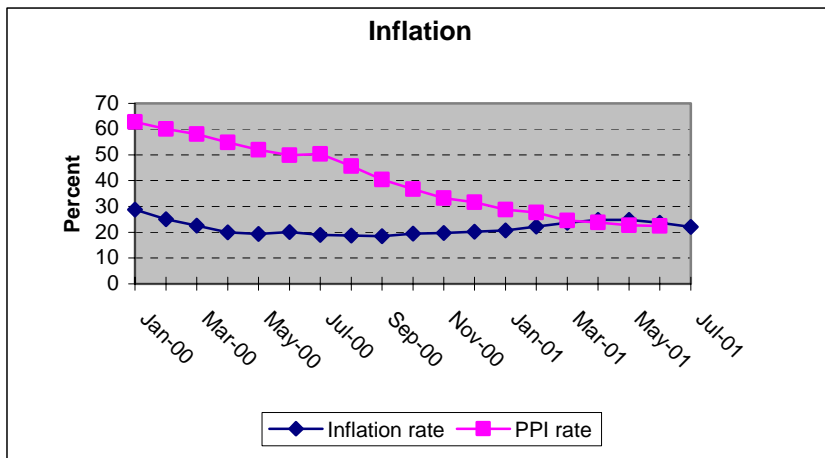
For the week the ruble firmed 0.15%, closing in the UTS on Friday at 29.4023/\$. MICEX weekly trade volumes were \$383.60 million, \$167.10 million and \$90.74 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.



## Prices

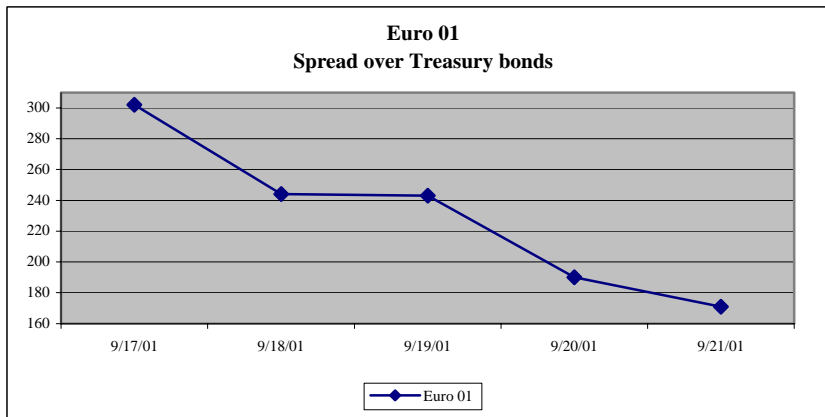
Prices grew by 0.1% during the first 17 days of September. Based on this trend, monthly inflation would be around 0.18%.

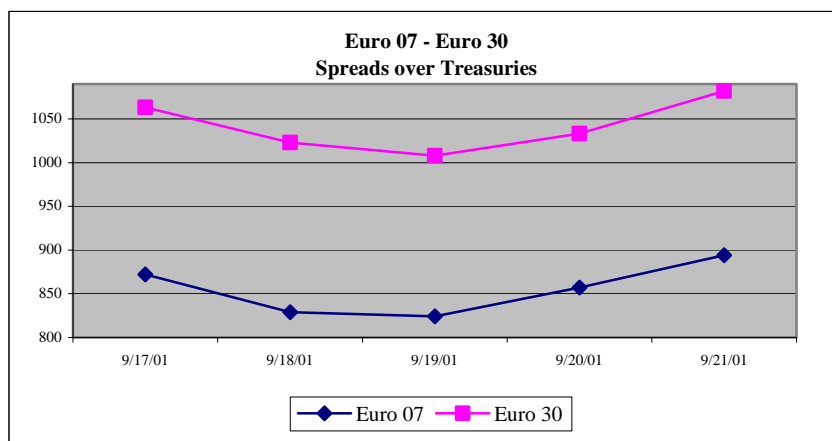
According to the CBR Chairman Geraschenko, inflation estimates will be in the range of 12-14% p.a. for at least 2-3 more years.



## Eurobonds

Eurobonds were unstable last week. The market was unsure about upcoming military operation would affect the emerging sector market and world oil prices. Downward pressure on Russian bond prices later in the week was caused by the Geraschenko statement that the level of reserves would stay the same through the rest of the year, and by Mr. Kudrin's announcement that Russia plans to borrow on the Eurobonds market in 2002 and 2003.

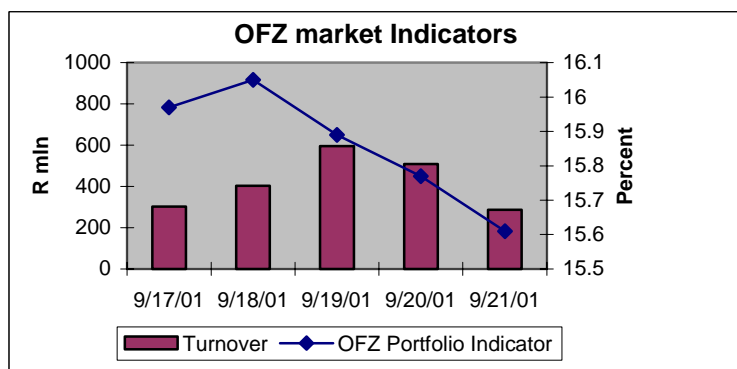




## Interest/Bond Market

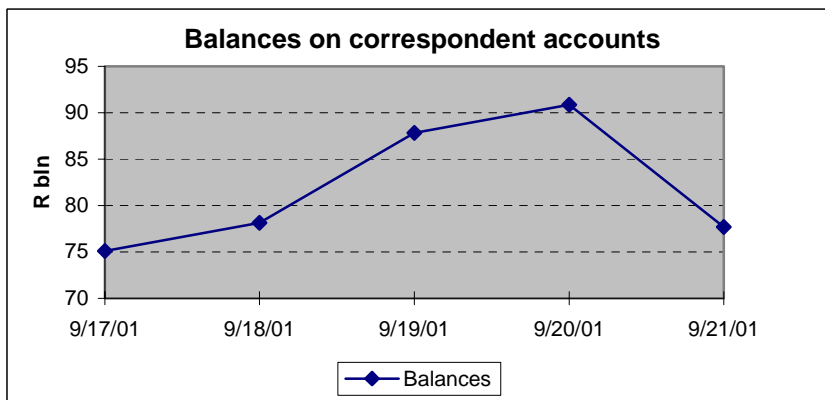
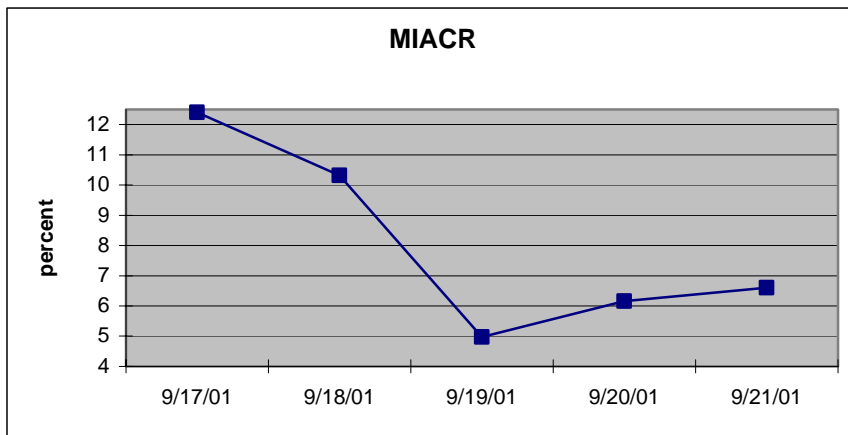
### *Bonds/Bills*

The secondary OFZ market was up again and yields reached record lows of 17.2% p.a. on the longest bonds. Low inflation and progress on the budget supported the market. MinFin announced it plans to issue new OFZ issues with maturities of 3-4 years and a six-month GKO issue. The total volume of issues would be no more than R10 billion.



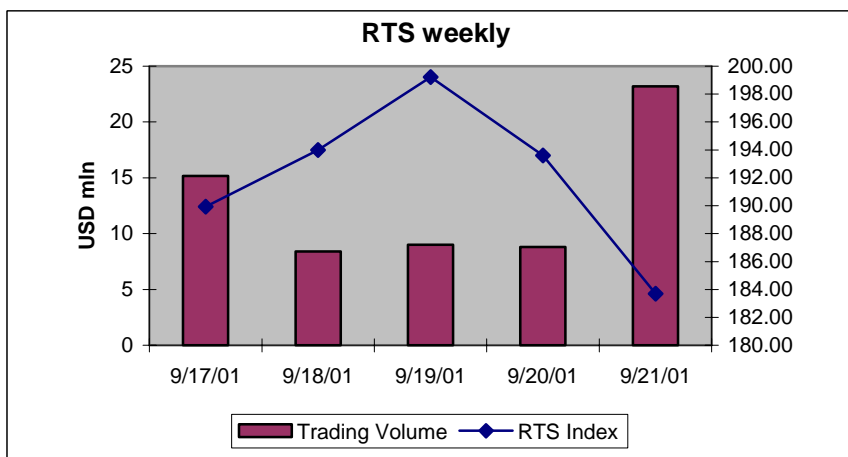
### *Overnight rates*

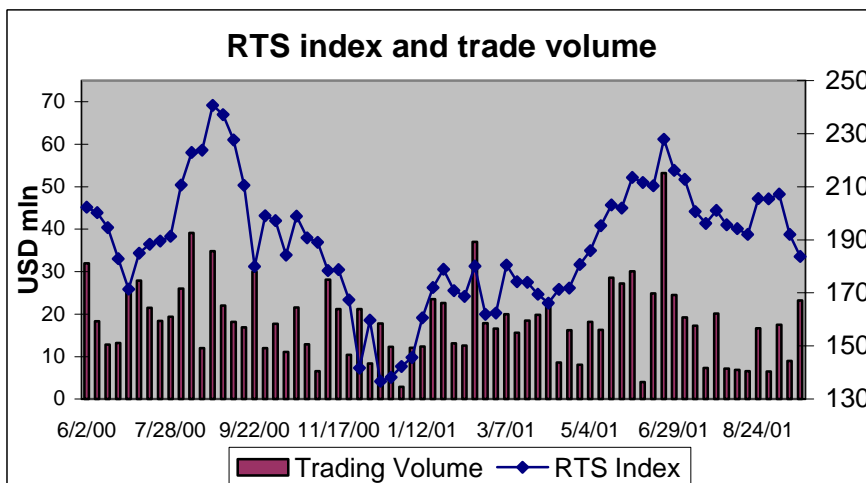
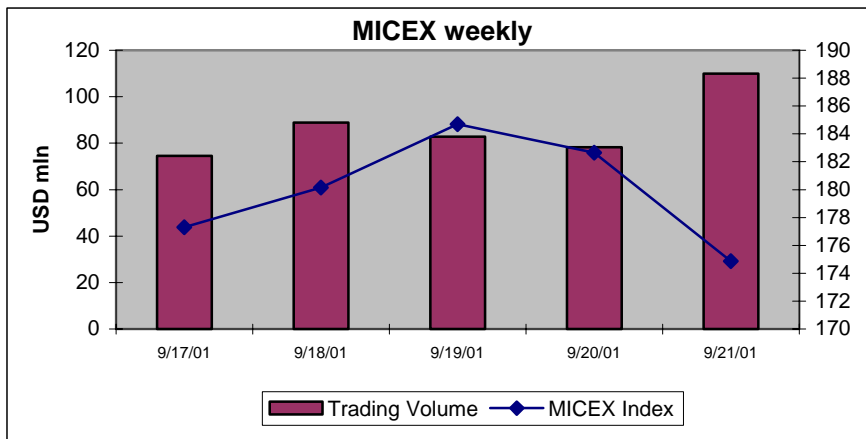
Banking liquidity was down in the beginning of the week but later the situation stabilized. Banks accumulated rubles to make VAT payments pushing balances on correspondent accounts to R90.9 billion on Thursday, but the next day they dropped by R13.2 billion. Overnight rates were higher than average during the first two days of the week (more than 10% p.a.) due to the ruble shortage, and then fell.



### Stock Market

The stock market was down 4.3% in dollar terms last week. The market grew for the first three days on growing oil prices and a lower than expected fall on world markets. However, later on it gave up those gains on uncertainty about U.S. retaliation. On Friday, the RTS index experienced a major hit of 5.13% on the back of selling of LUKoil (down by 5.97%) and RAO UES (-5.16%).

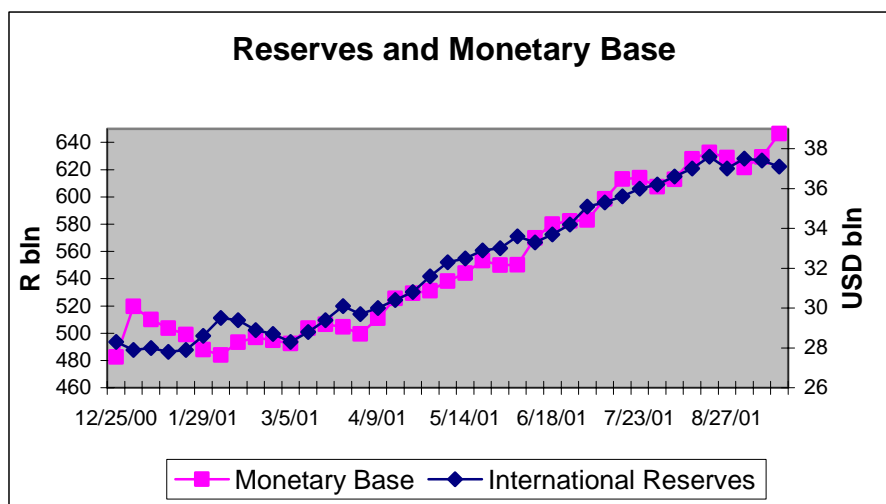




### International Reserves and Monetary Base

International reserves of the Finance Ministry and Central Bank fell for the second straight week to \$37.1 billion. Rather than any slowdown in dollar inflows, the main reason for the drop is that MinFin has begun to gear up for fall external debt payments. MinFin owes \$1.2 billion in external payments in September and about \$1 billion on Eurobonds in November and has been buying dollars to cover the payments. Meanwhile in October CBR will have to make quarterly payments of \$500 million on a \$2.8-billion IMF loan. As a result, CBR Chairman Viktor Geraschenko said that in the next 2-3 months reserves would fluctuate around \$37 billion. Over the medium term he said that reserves of \$42-45 billion should be enough to cover external debt payments and at the same time maintain the stability of the ruble.

The Monetary Base jumped last week by R17.2 billion to R646.5 billion. The sharp increase appeared to be triggered by Russians converting bank deposits into cash as a result of uncertainty following the attacks on the U.S.



### Questions or Comments?

Please send your questions or comments on this Weekly to [ustreasu@online.ru](mailto:ustreasu@online.ru).

### EXPLANATORY NOTES

**1. EXCHANGE RATES:** SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

**2. INTEREST RATES:** Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

**3. STOCK INDICES:** The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

**4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION** represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-



resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

**5. MONETARY BASE** (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

**6. LOMBARD CREDITS**, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.